

DOUBLE TAXATION

Taxes on Income

**Protocol Between the
UNITED STATES OF AMERICA
and BARBADOS
Amending Convention of
December 31, 1984**

Signed at Washington December 18, 1991

and

Exchange of Notes

with

Understandings



NOTE BY THE DEPARTMENT OF STATE

Pursuant to Public Law 89—497, approved July 8, 1966
(80 Stat. 271; 1 U.S.C. 113)—

“ . . .the Treaties and Other International Acts Series issued under the authority of the Secretary of State shall be competent evidence . . . of the treaties, international agreements other than treaties, and proclamations by the President of such treaties and international agreements other than treaties, as the case may be, therein contained, in all the courts of law and equity and of maritime jurisdiction, and in all the tribunals and public offices of the United States, and of the several States, without any further proof or authentication thereof.”

BARBADOS

Double Taxation: Taxes on Income

*Protocol to convention of December 31, 1984.
Signed at Washington December 18, 1991;
Transmitted by the President of the United States of America
to the Senate September 30, 1992 (Treaty Doc. 102-41,
102d Congress, 2d Session);
Advice and consent to ratification by the Senate
November 20, 1993;
Ratified by the President December 20, 1993;
Ratifications exchanged at Bridgetown December 29, 1993;
Entered into force December 29, 1993.
And exchange of notes with understandings.*

PROTOCOL AMENDING THE CONVENTION BETWEEN
THE UNITED STATES OF AMERICA AND BARBADOS
FOR THE AVOIDANCE OF DOUBLE TAXATION AND
THE PREVENTION OF FISCAL EVASION WITH RESPECT
TO TAXES ON INCOME SIGNED ON DECEMBER 31, 1984

The United States of America and Barbados, desiring to conclude a Protocol to amend the Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income signed on December 31, 1984, (hereinafter referred to as "the Convention") have agreed as follows:

ARTICLE I

1. Article 5 (Permanent Establishment) of the Convention shall be deleted and replaced by the following:

"ARTICLE 5

Permanent Establishment

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term "permanent establishment" includes especially

- a) a place of management;
- b) a branch;
- c) an office;
- d) a factory;
- e) a workshop; and
- f) a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources.

3. A building site or construction or installation project, or an installation or drilling rig or ship used for the exploration or exploitation of natural resources, constitutes a permanent establishment only if it lasts more than 183 days in any 12-month period.

4. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:

a) the use of facilities solely for the purpose of storage, display, or delivery of goods or merchandise belonging to the enterprise;

b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display, or delivery;

c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise;

e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;

f) the maintenance of a fixed place of business solely for any combination of the activities mentioned in subparagraphs a) to e).

5. Notwithstanding the provisions of paragraphs 1 and 2, where a person - other than an agent of an independent status to whom paragraph 6 applies - is acting on behalf of an enterprise and has and habitually exercises in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

6. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent, or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

7. The fact that a company which is a resident of a Contracting State controls or is controlled by a company, which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other."

ARTICLE II

Paragraph 1 of Article 7 (Business Profits) of the Convention shall be deleted and replaced by the following:

"1. The business profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on or has carried on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on or has carried on business as aforesaid, the business profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment."

ARTICLE III

1. The following shall be added to paragraph 2 of Article 10 (Dividends) of the Convention, immediately preceding the last sentence of the paragraph:

"Subparagraph (a) shall not apply in the case of dividends paid by a United States Regulated Investment Company or Real Estate Investment Trust. Subparagraph (b) shall apply in the case of dividends paid by a Regulated Investment Company. In the case of dividends paid by a Real Estate Investment Trust, subparagraph (b) shall apply if the beneficial owner of the dividends is an individual holding a less than 10 percent interest in the Real Estate

Investment Trust; otherwise the rate of tax applicable under domestic law shall apply."

2. The second sentence of paragraph 5 of Article 10 (Dividends) of the Convention shall be deleted and replaced by the following:

"In addition, a company which is a resident of Barbados shall be exempt from United States accumulated earnings tax if individuals (other than United States citizens) who are residents of Barbados control directly or indirectly throughout the last half of the taxable year more than 50 percent of the entire voting power or value of the company."

3. Paragraph 6 of Article 10 (Dividends) shall be deleted and replaced by the following:

"6. Where a company that is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or are attributable to a permanent establishment or a regular base situated in that other State, even if the dividends paid consist wholly or partly of profits or income arising in such other State."

ARTICLE IV

In paragraph 1 of Article 11 (Interest) of the Convention, the phrase "12.5 percent" shall be replaced by "5 percent".

ARTICLE V

In paragraph 2 of Article 12 (Royalties) of the Convention, the phrase "12.5 percent" shall be replaced by "5 percent".

ARTICLE VI

A new Article 13A (Branch Tax) shall be added to the Convention as follows:

"ARTICLE 13A

Branch Tax

(1) A company which is a resident of a Contracting State may be subject in the other Contracting State to a tax in addition to the tax allowable under the other provisions of this Convention.

(2) Such tax may be imposed only on:

(a) in the case of the United States:

(i) the "dividend equivalent amount" of the business profits of the company which are effectively connected (or treated as effectively connected) with the conduct of a trade or business in the United States and which are either attributable to a permanent establishment in the United States or subject to tax in the United States under Article 6 (Income from Real Property) or Article 13 (Gains) of this Convention; and

(ii) the excess, if any, of interest deductible in the United States in computing the profits of the company that are subject to tax in the United States and are either attributable to a permanent establishment in the United States or subject to tax in the United States under Article 6 (Income from Real Property) or Article 13 (Gains) of this Convention over the interest paid by or from the permanent establishment or trade or business in the United States; and

(b) in the case of Barbados:

(i) on amounts sufficient to provide that a branch in Barbados of a United States company (or a company of the United States otherwise taxable on net income in Barbados) is taxed in a manner comparable to a similarly situated Barbadian company and its United States shareholder; and

(ii) on interest expenses which are deductible for computing the income described in the preceding sub-subparagraph, and which are comparable to amounts described in subparagraph (a)(ii) of this paragraph.

(3) The taxes described in paragraph (2) of this Article shall not be imposed at a rate exceeding:

(a) the rate specified in paragraph (2)(a) of Article 10 (Dividends) for the taxes described in subparagraphs (a)(i) and (b)(i) of paragraph (2) of this Article; and

(b) the appropriate rate specified in paragraph (1) of Article 11 (Interest) for the taxes described in subparagraphs (a)(ii) and (b)(ii) of paragraph (2) of this Article."

ARTICLE VII

Article 22 (Limitation on Benefits) of the Convention shall be deleted and replaced by the following:

"ARTICLE 22

Limitation on Benefits

1. A person that is a resident of a Contracting State and derives income from the other Contracting State

shall be entitled, in that other Contracting State, to all the benefits of this Convention only if such person is:

(a) an individual;

(b) a Contracting State or a political subdivision or local authority thereof;

(c) engaged in the active conduct of a trade or business in the first-mentioned Contracting State (other than the business of making or managing investments, unless these activities are banking or insurance activities carried on by a bank or insurance company), and the income derived from the other Contracting State is derived in connection with, or is incidental to, that trade or business;

(d) a company in whose principal class of shares there is substantial and regular trading on a recognized stock exchange;

(e) (i) a person, more than 50 percent of the beneficial interest in which (or in the case of a company, more than 50 percent of the number of shares of each class of whose shares) is owned, directly or indirectly, by persons entitled to

the benefits of this Convention under subparagraphs (a), (b), (d), or (f) or who are citizens of the United States; and

(ii) a person, more than 50 percent of the gross income of which is not used, directly or indirectly, to meet liabilities (including liabilities for interest or royalties) to persons not entitled to the benefits of this Convention under subparagraphs (a), (b), (d), or (f) and who are not citizens of the United States; or

(f) an entity that is a not-for-profit organization and that, by virtue of that status, is generally exempt from income taxation in its Contracting State of residence, provided that more than half of the beneficiaries, members or participants, if any, in such organization are persons that are entitled, under this Article, to the benefits of this Convention.

2. A person that is not entitled to the benefits of this Convention pursuant to the provisions of paragraph 1 may, nevertheless, be granted the benefits of the Convention if the competent authority of the State in which the income in question arises so determines.

3. For the purposes of paragraph 1, the term "recognized stock exchange" means:

(a) the NASDAQ System owned by the National Association of Securities Dealers, Inc. and any stock exchange registered with the Securities and Exchange Commission as a national securities exchange for purposes of the Securities Exchange Act of 1934; and

(b) any other stock exchange agreed upon by the competent authorities of the Contracting States.

4. The competent authorities of the Contracting States shall consult together with a view to developing a commonly agreed application of the provisions of this Article. The competent authorities shall, in accordance with the provisions of Article 26 (Exchange of Information), exchange such information as is necessary for carrying out the provisions of this Article and safeguarding, in cases envisioned therein, the application of their domestic law."

ARTICLE VIII

1. This Protocol shall be ratified and instruments of ratification shall be exchanged as soon as possible.

2. The Protocol shall enter into force upon the exchange of instruments of ratification, and shall have effect

(a) in respect of taxes imposed in accordance with Articles 10 (Dividends), 11 (Interest) and 12 (Royalties) for amounts paid or credited on or after the first day of the second month next following the date on which this Protocol enters into force;

(b) in respect of other taxes, for taxable years beginning on or after the first day of January next following the date on which the Protocol enters into force.

IN WITNESS WHEREOF, the undersigned, duly authorized thereto by their respective Governments, have signed this Protocol.

Done at Washington, in duplicate, this 18th day of December, 1991.

FOR THE
UNITED STATES OF AMERICA:

Sam J. McAllister

FOR
BARBADOS:

Rudi V. Webster

DEPARTMENT OF STATE
WASHINGTON

December 18, 1991

Excellency:

I have the honor to refer to the Protocol signed today amending the Convention between the United States of America and Barbados for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and to inform you on behalf of the Government of the United States of America of the following:

During the negotiations leading to the conclusion of the Protocol signed today, the negotiators developed an agreed Memorandum of Understanding intended to give guidance both to taxpayers and tax authorities of our two countries in interpreting Article 22 (Limitation on Benefits). The guidance represents the current views of our two countries with respect to Article 22. Future developments, including experience in administering the Convention as amended by the Protocol, and Article 22, may lead the competent authorities to develop and publish further developments and understandings.

His Excellency
Sir William Douglas,
Ambassador of Barbados.

If this position meets the approval of the Government of Barbados, this Note and your Note in reply thereto will indicate that our Governments share a common understanding of the role of the memorandum of understanding relating to the Protocol.

Accept, Excellency, the expression of my highest consideration.

A handwritten signature in black ink, appearing to read "Guy J. McAllister". The signature is written in a cursive, slightly slanted style.

For the Acting Secretary of State:



Embassy of Barbados
2144 Wyoming Avenue, N.W.
Washington, D.C. 20008

U.S. 1 (A)

December 18, 1991

Excellency,

I have the honour to refer to the Protocol signed today amending the Convention between the United States of America and Barbados for the Avoidance of double Taxation and the Prevention of Fiscal Evasion with respect to taxes on Income and to inform you on behalf of the Government of Barbados of the following:

During the negotiations leading to the conclusion of the Protocol signed today, the negotiators developed an agreed Memorandum of Understanding intended to give guidance both to taxpayers and tax authorities of our two countries in interpreting Article 22 (Limitation on Benefits). The guidance represents the current views of our two countries with respect to Article 22. Future developments, including experience in administering the Convention as amended by the Protocol, and Article 22, may lead the competent authorities to develop and publish further developments and understandings.

This position meets the approval of the Government of Barbados and this Note in reply indicates that our Governments share a common understanding of the role of the Memorandum of Understanding relating to the Protocol.

Accept, Excellency, the expression of my highest consideration.

Dr. Rudi Webster
Ambassador

The Honourable James Baker III
Secretary of State
Department of State
Washington, D.C. 20520

UNDERSTANDINGS REGARDING THE SCOPE OF THE
LIMITATION ON BENEFITS ARTICLE
IN THE U.S.-BARBADOS PROTOCOL

A. Business Connection

Paragraph 1(c) of Article 22 (Limitation on Benefits) of the U.S.-Barbados Income Tax Convention, as amended by the Protocol, provides that benefits will be granted with respect to income derived in connection with or incidental to an active trade or business in the State in which the income recipient resides. This provision is self executing; unlike the provisions of paragraph 2, discussed in section B, below, it does not require advance competent authority ruling or approval.

The following examples illustrate the intention of the negotiators with respect to the interpretation of the provisions of paragraph 1(c). The examples are not intended to be exhaustive of the kinds of cases which would fall within the scope of the paragraph. All of the examples are intended to be understood reciprocally.

Paragraph 1(c) is relevant only in cases in which the entity claiming treaty benefits is not entitled to benefits under either the ownership and base erosion tests of paragraph 1(e) or the public trading test of paragraph 1(d).

Example I

Facts: A Barbadian resident company is owned by three persons, each resident in a different third country. The company is engaged in an active international marketing business in Barbados. It purchases goods in Asia and sells them throughout the Western Hemisphere, including the United States. It has a trade or business in the United States but no permanent establishment under Article 5 of the treaty. The Barbadian company is engaged in the United States in selling the goods which it has purchased in Asia. The active purchasing and selling business in Barbados of the Barbadian company is substantial in relation to the activities of the company's trade or business in the United States. Is the Barbadian company, by virtue of Articles 5 and 7 of the treaty, exempt from U.S. tax on its income effectively connected with its U.S. trade or business?

Analysis: Treaty benefits would be allowed, and the income would be exempt because the treaty requirement that the U.S. income is "derived in connection with or is incidental to" the Barbadian active business is satisfied. This conclusion is based on two elements in the fact pattern presented: (1) the income is connected with the active Barbadian business -- in this example in the form of a "downstream"

connection; and (2) the active Barbadian business is substantial in relation to the business carried on in the United States.

Example II

Facts: The facts are the same as in Example I except that while the income is derived by a Barbadian company of which the U.S. trade or business is a part, the relevant business activity in Barbados (i.e., the worldwide purchasing and selling activity) is carried on by a Barbadian subsidiary company of the first company. The Barbadian subsidiary's activities meet the business relationship and substantiality tests of the business connection provision, as described in the preceding example. Is the effectively connected U.S. income of the U.S. trade or business exempt from U.S. tax under Articles 5 and 7 of the treaty?

Analysis: The income is exempt because the two Barbadian entities (i.e., the one deriving the income and the one carrying on the substantial active business in Barbados) are related. Benefits are not denied merely because the income is earned by one Barbadian company and the relevant activity is carried on in Barbados by a related Barbadian company.

The existence of a similar multiple company structure in the United States would not affect the right of the Barbadian company receiving the income to treaty benefits. If, for example, a Barbadian company owns a subsidiary in the United States which is, itself, a holding company for the group's U.S. activities, and those activities are connected with the business activity of the parent or a related company in Barbados, dividends paid by the U.S. holding company to the Barbadian parent holding company would be tested for eligibility for benefits, in the same way as described above, ignoring the fact that the activities are carried on by one entity and the income in respect of which benefits are claimed is paid by another, related, entity.

Example III

Facts: A U.S. resident company is owned by three persons, each resident in a different third country. The company is the worldwide headquarters and parent of an integrated international business carried on through subsidiaries in many countries, including Barbados. The company's wholly owned U.S. and Barbadian subsidiaries manufacture, in their countries of residence, different products, each of which are part of the group's product line. The Barbadian subsidiary has been capitalized with debt and equity. The active manufacturing business of the U.S. subsidiary is substantial in relation to the activities of the Barbadian subsidiary. The U.S. parent manages the worldwide group and also performs research and development to improve the manufacture

of the group's product line. Are the Barbadian subsidiary's dividend and interest payments to its U.S. parent eligible for treaty benefits in Barbados?

Analysis: Treaty benefits would be allowed because the treaty requirement that the Barbadian income is "derived in connection with or is incidental to" the U.S. active business is satisfied. This conclusion is based on two elements in the fact pattern presented: (1) the income is connected with the U.S. active business because the Barbadian subsidiary and the U.S. subsidiary each manufacture products which are part of the group's product line, the U.S. parent manages the worldwide group, and the parent performs research and development that benefits both subsidiaries; and (2) the active U.S. business is substantial in relation to the business of the Barbadian subsidiary.

Example IV

Facts: A third-country resident establishes a Barbadian company for the purpose of acquiring a large U.S. manufacturing company. The sole business activity of the Barbadian company (other than holding the stock of the U.S. company) is the operation of a small retailing outlet in Barbados which sells products manufactured by the U.S. company. Is the Barbadian company entitled to treaty benefits under paragraph 1(c) with respect to dividends it receives from the U.S. manufacturer?

Analysis: The dividends would not be entitled to benefits. Although there is, arguably, a business connection between the U.S. and the Barbadian businesses, the "substantiality" test described in the preceding examples is not met.

Example V

Facts: U.S., French and Canadian companies create a joint venture in the form of a partnership organized in the United States to manufacture a product in a developing country. The joint venture owns a Barbadian sales company which pays dividends to the joint venture. Are these dividends eligible for reduced Barbadian withholding under the U.S.-Barbados treaty?

Analysis: Under Article 4, only the U.S. partner is a resident of the United States for purposes of the treaty. The question arises under this treaty, therefore, only with respect to the U.S. partner's share of the dividends. If the U.S. partner meets the public trading or ownership and base erosion tests of subparagraphs 1(d) or (e), it is entitled to benefits without reference to paragraph 1(c). If not, the analysis of the previous examples would

be applied to determine eligibility for benefits under 1(c). The determination of Barbadian treaty benefits available to the French and Canadian partners will be made under Barbadian treaties with France and Canada, or, in the absence of such treaties, under the provisions of Barbados law.

Example VI

Facts: A Barbadian company, a Jamaican company and a Trinidadian company create a joint venture in the form of a Barbadian resident company in which they take equal share holdings. The joint venture company engages in an active data processing business in Barbados. Income derived from that business that is retained as working capital is invested in U.S. Government securities and other U.S. debt instruments until needed for use in the business. Is interest paid on these instruments eligible for U.S.-Barbados treaty benefits?

Analysis: The interest would be eligible for treaty benefits. Interest income earned from short-term investment of working capital is incidental to the business in Barbados of the Barbadian joint venture company.

B. Competent Authority Discretion under Paragraph 2

As indicated above, treaty benefits may be claimed by the taxpayer under the provisions of paragraph 1 (ownership, base erosion, public trading and business connection) without reference to competent authority. It is anticipated that in the vast majority of cases, eligibility for treaty benefits will be determinable without resort to competent authorities. The tax authorities of the Contracting States may, of course, in reviewing a case determine that the taxpayer has improperly interpreted the provisions of paragraph 1, and that benefits should not have been granted. Furthermore, under paragraph 2 the competent authority of the source State may determine that, notwithstanding failure to qualify for benefits under paragraph 1, benefits should be granted.

It is assumed that, for purposes of implementing paragraph 2, taxpayers will be permitted to present their cases to the competent authority for an advance determination based on the facts, and will not be required to wait until the tax authorities of one of the Contracting States have determined that benefits are denied. In these circumstances, it is also expected that if competent authority determines that benefits are to be allowed, they will be allowed retroactively to the time of entry into force of the relevant treaty provision or the establishment of the structure in question, whichever is later.

In making determinations under paragraph 2, it is understood that the competent authorities will take into account all relevant facts and circumstances. The factual criteria which the competent authorities are expected to take into account include the existence of a clear business purpose

for the structure and location of the income earning entity in question; the conduct of an active trade or business (as opposed to a mere investment activity) by such entity; and a valid business nexus between that entity and the activity giving rise to the income. The competent authorities will, furthermore, consider, for example, whether and to what extent a substantial headquarters operation conducted in a Contracting State by employees of a resident of that State contribute to such valid business nexus, and should not, therefore, be treated merely as the "making or managing [of] investments" within the meaning of paragraph 1(c) of Article 22.

The discretionary authority granted to the competent authorities in paragraph 2 is particularly important in view of, and should be exercised with particular cognizance of, the developments in, and objectives of, international economic integration, such as that among the member countries of the CARICOM and under the proposed North American Free Trade Agreement.

The following example illustrates the application of the principles described in Section B, above.

Example VII

Facts: Barbadian, Jamaican and Antiguan companies, each of which is engaged directly or through its affiliates in substantial active business operations in its country of residence, decide to cooperate in the development and marketing of a new computer spreadsheet program through a corporate joint venture with its statutory seat in Barbados. The development and marketing aspects of the project are carried out by the individual joint venturers. The joint venture company, which is staffed with a significant number of managerial and financial personnel seconded by the joint venturers, acts as the general headquarters for the joint venture, responsible for the overall management of the project including coordination of the functions separately performed by the individual joint venturers on behalf of the joint venture company, development of sales strategies, and the investment of working capital contributed by the joint venturers and the financing of the project's additional capital requirements through public and private borrowings. The joint venture company derives portfolio investment income from U.S. sources generated by working capital investments. Is this income eligible for benefits under the U.S.-Barbados treaty?

Analysis: If the joint venture company's activities constitute an active business and the income is connected to that business, benefits would be allowed under paragraph 1(c). If not, it is expected that the U.S. competent authority would determine that treaty benefits should be allowed in accordance with paragraph (2) under the facts presented, particularly in view of (1) the clear business purpose for the

formation and location of the joint venture company; (2) the significant headquarters functions performed by that company in addition to financial functions; and (3) the fact that all of the joint venturers are companies resident in CARICOM member countries in which they are engaged directly or through their affiliates in substantial active business operations.

The competent authorities will consult further on these issues and develop additional standards for the application of the Article as they gain experience with the application of these rules.